LEARN ABOUT

Buying an Annuity

Annuity.org

6 Steps to Buying an Annuity

1 Assess your current and future financial needs.

Enlist the help of a professional, if necessary, and look for useful retirement planning questionnaires online.

2 Choose an annuity product based on your objectives.

Consider your financial goals — income or growth, for example — and carefully review the contract terms for alignment with your objectives.

3 Select your provider.

Refer to financial rating agencies, such as Moody's and Standard & Poor's, to get recent ratings on annuity providers.

4 Complete the application.

Fill out the application completely and accurately to lock in your rate.

5 Transfer the funds.

You can pay with cash, retirement funds or a transfer from a brokerage account. Make sure you understand the tax implications of your payment type.

6 Take advantage of the free look period.

Most insurance companies give buyers a period of 10 to 30 days from the contract start date to reject the annuity and receive a refund.

Reasons to Buy an Annuity

Annuity expert Stan Garrison Haithcock devised an acronym to describe the benefits of annuities: PILL. It stands for Premium Protection, Income for Life, Legacy and Long-Term Care.

Premium Protection

You will always walk away with your purchase payment no matter what.

Income for Life

Many annuities provide the annuitant a stream of guaranteed retirement income for his or her entire life.

Legacy

Death benefit riders can allow you to pass on your annuity to one or more named beneficiaries when you die.

Long Term Care

Long-term care riders are an option in many annuity contracts. They provide a level of insurance against the expenses of long-term care should you need it.

How Are Annuities Taxed?

All annuities are allowed to grow tax-deferred, which means you won't owe taxes until you start receiving payments.

If you purchase an annuity with **after-tax money**, you will owe taxes only on the interest and earnings.

$100,000 — Growth → $120,000

Annuity Purchased with After-Tax Money

$20,000
Interest and Earnings = Taxable

$100,000
Principal = Not Taxable

If you purchase an annuity with **pre-tax dollars**, such as funds from an IRA or a 401(k), payments you receive are taxed as income.

$100,000 — Growth → $120,000

Annuity Purchased with Pre-Tax Money

$120,000
Principal + Interest + Earnings = Taxable

How Do You Calculate Annuity Payments?

You can estimate the monthly payments from an annuity if you know the price of the annuity, the fixed interest rate, the frequency of your payments and the number of years the annuity will provide you with income.

Once you have these figures, you can use the Payout Annuity Formula to get an estimated monthly income.

Payout Annuity Formula

P_0 = Principal

PMT = Monthly Payment Amount

r = Annual Interest Rate

n = Number of payments per year

t = Number of Years of Payments

$$P_0 = \frac{PMT\left(1-\left(1+\frac{r}{n}\right)^{-nt}\right)}{\left(\frac{r}{n}\right)}$$

Estimated Monthly Payments for a $100,000 Annuity

P_0 = $100,000 PMT = Monthly Payment Amount

r = 2% n = 12 t = 20

$$\$100{,}000 = \frac{PMT\left(1-\left(1+\frac{.02}{12}\right)^{-(12)(20)}\right)}{\left(\frac{.02}{12}\right)}$$

Estimated Monthly Payment = $505.88

Sources

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